

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NORTH CAROLINA
RALEIGH DIVISION

FILED

25 JUL 2000

IN RE: *INTERNATIONAL HERITAGE, INC.*

INTERNATIONAL HERITAGE, INCORPORATED

PEGGY B. DEANS, CLERK
U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF N.C.

CASE NO. 99-02675-5-ATS

99-02674-5-ATS

TRANSCRIPT OF PROCEEDINGS

**TRUSTEE'S MOTION FOR APPROVAL OF COMPROMISE AND
SETTLEMENT**

MAY 31, 2000

RALEIGH, NORTH CAROLINA

BEFORE THE HONORABLE A. THOMAS SMALL
UNITED STATES BANKRUPTCY JUDGE

APPEARANCES

Trustee: *Holmes P. Harden*

Attorney for Larry Smith, Stanley Van Etten, and
Wood & Francis: *Brent Wood*

Attorneys for Stanley Van Etten: *Wade Smith, Melissa Hill*

Attorneys for Georgina Mollick: *Joseph B. Cheshire, V*

Attorney for Claude Savage: *John P. O'Hale*

Attorney for John David Brothers and Dee Anne Brothers:
Stephen T. Smith

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1 (CALL TO ORDER)

2 THE COURT: Mr. Harden?

3 MR. HARDEN: Thank you, Your Honor. I've given you
4 all of my cases. I need one back. I want to give one to the
5 judge. Judge, I'm handing up the *Weintraub* case. It's a
6 Supreme Court case you may already be aware of. It's my
7 opinion--of course, this is my motion to waive the
8 attorney/client and work product privileges in favor of the
9 U.S. Attorney--it's my opinion pursuant to the *Weintraub* case
10 that there's no question that the estate, the trustee, has
11 the authority to waive the attorney/client privilege.

12 As far as the work product privilege is concerned, I
13 think that's probably a dual privilege that's shared by the
14 client and his attorney, and what I want the Court to do
15 today, Judge, is to allow me to waive that to the extent I
16 possibly can. I don't think that I can possibly waive say
17 Mr. Wood's objections to producing his internal memoranda or
18 legal opinions or ideas that he would call his own work
19 product; but to the extent that the estate or the debtor
20 prior to the bankruptcy produced any trial preparation sorts
21 of documents, I think it would be my privilege to waive the
22 right to receive access to those, and I would like the Court
23 to do that.

24 I did not know whether this proposal needed to be
25 noticed out under 9019, so I thought it was the better part

1 of valor to go ahead and do that, particularly assuming there
2 will be shareholders in this corporation who would not want
3 the attorney/client privilege waived--shareholders, officers,
4 and directors.

5 And my duty is to the estate obviously. I have a
6 dual obligation to the shareholders and to the creditors, and
7 what I'd like the Court to find today is that the creditors
8 in this case should have the higher consideration and
9 priority in that obligation because this, pursuant to the
10 *Weintraub* case in particular, is I think the best thing for
11 the creditors.

12 It's my obligation obviously to make the estate
13 grow, and my reasoning is that the U.S. Attorney is going to
14 provide two things. He will agree not to pursue any
15 forfeitures, fines, or penalties, and he will agree that any
16 restitution that may be paid if there are prosecutions and
17 convictions, that any restitution that may be paid, that he
18 would do his best to see that that money came back to the
19 estate to be paid to creditors similar to the arrangement
20 that we made with the SEC with the bond money there, and
21 frankly, I learned recently that there is a great deal of
22 information I haven't even seen, some 3½ inch thick stack of
23 privileged documents--lists, single space--of privileged
24 documents. That may be wrong--Mr. Wood can correct me--but
25 there may be thousands of documents that I have not seen as

1 trustee, and I think it would be—it's my obligation to see
2 what's in those documents. There may be information in those
3 documents that would lead me to causes of action against
4 other insiders that I don't know about right now, and this
5 would add another level of scrutiny to the case that hasn't
6 been available to me at this point.

7 If we don't do this deal, I think the U.S. Attorney
8 is going to do one of two things, or both. He's going to go
9 over to the District Court and argue the crime fraud
10 exception to the waiver of the attorney/client privilege, or
11 to the attorney/client privilege in lieu of the waiver, and
12 I'm going to get dragged into that at the estate's expense.
13 There will not be a deal pursuant to that. You know, if it
14 succeeds with the District Court, the estate will not benefit
15 whatsoever, and you might as well argue that we already
16 waived the privilege when we did the settlement with the SEC.
17 As you recall, one of the terms that they insisted upon was
18 that the trustee waive the attorney/client privilege, and in
19 this circuit, a waiver for one purpose is a waiver for
20 everything else. So, you know, if that waiver for that
21 litigation was a valid waiver—it may or may not have been,
22 Your Honor—I don't know whether the SEC got hold of any
23 confidential information, but we did agree to provide that to
24 them. It occurred at the end of that case. And I can't tell
25 you whether in the litigation that sort of petered out at the

1 end, any confidential attorney/client information was
2 conveyed to the SEC, but we did agree to do that.

3 Again, if that argument prevails, there won't be any
4 benefit to the estate whatsoever. I want to put the
5 creditors in a position to benefit. I don't know whether
6 they would benefit monetarily from restitution or not. There
7 may not be any prosecutions. There may not be any
8 convictions. But I don't see any downside, no compelling
9 reason, for me not to waive the privilege as has been
10 proposed.

11 The only negative that I can think of is that we
12 still have litigation ongoing with TIG Insurance Company, but
13 I've spoken to—and that could obviously create a waiver in
14 that case as well—I've spoken to Mr. Roberts. I believe Mr.
15 Roberts is handling that matter for the estate, and we have
16 decided that whatever marginal advantage that might give to
17 TIG is not worth passing on this proposal from the U.S.
18 Attorney. There may be some marginal benefit, but we just
19 don't think it's something that ought to derail the proposal
20 that's on the table.

21 And that's all I have to say at this point, Your
22 Honor. I'd like to respond to the other attorneys.

23 THE COURT: Okay. Mr. Wood?

24 MR. WOOD: Thank you, Your Honor. As the clerk
25 indicated, I'm here in three capacities, obviously on behalf

1 of Mr. Van Etten, whom I have represented throughout this
2 matter; I'm here on a limited appearance on behalf of Mr.
3 Smith, who I had represented in some other bankruptcy
4 proceedings and he asked me to object on his behalf as to
5 this issue as an officer and director; and I'm here on behalf
6 of my firm.

7 And as Mr. Harden has correctly pointed out, there
8 are some related privileges that my firm has, and also, quite
9 frankly, Your Honor, my firm has duties to a lot of people as
10 a result of our representation, and frankly, I did not want
11 to run afoul of any state bar ethical issues by not letting
12 the Court know that by waiving the privilege, it creates-
13 places my firm and a lot of other law firms in the cross-
14 hairs of not necessarily liability but disputes between
15 obligations to different parties, and I think that will
16 become clear to the Court.

17 With me today are Wade Smith and Melissa Hill of the
18 firm Barrington Smith, and they represent Mr. Van Etten only.
19 I probably misled the clerk a little bit on that, but I
20 wanted to make sure I clarified that. And Mr. Smith will be
21 making arguments, with the Court's permission, as well on
22 behalf of Mr. Van Etten after I conclude my comments.

23 We do, Your Honor-or we are here to vehemently
24 oppose the trustee's attempt to waive the privilege. We
25 believe it's unnecessary. This is a constitutionally

1 protected right which we do not believe, under the
2 circumstances that the trustee has presented, should be
3 waived. I have handed to the clerk copies of a brief that my
4 firm has prepared in support of our position, and I will
5 reiterate some of the points that I've made in my brief and
6 ask the Court to consider both my oral and my written
7 arguments in this regard.

8 First, Your Honor, the trustee has failed to point
9 out to the Court—may not have been aware, and I do want to
10 give him the benefit of the doubt—the fact that this
11 corporation in its bylaws had an indemnification provision.
12 The key provision is set forth within my brief, and it
13 clearly indemnifies the officers and directors in this
14 situation. While maybe not an indemnification from criminal
15 fines as a result of statutory authority that might prevent
16 that, in fact, Your Honor, it would provide them legal fees
17 in this situation.

18 Thus, what the trustee is ignoring is the fact that
19 these individuals, not just Mr. Van Etten, may have a claim
20 that would arise as a result of the trustee waiving the
21 privilege here. They probably have a claim as of right now.
22 Similarly, Your Honor, Mr. Van Etten entered into an
23 employment agreement that had a similar indemnification
24 provision. Again, it is set forth in my brief, so I will not
25 reiterate that.

1 Factually, Your Honor, I believe it's extremely
2 important for me to reiterate what the Court may already
3 know. International Heritage was a multi-level marketing
4 company. Multi-level marketing companies survive in a
5 complex legal environment. They are scrutinized by a variety
6 of different state and federal regulatory agencies. The
7 Court is well aware of the actions by the Montana State
8 Auditor's Office on securities issues, the Securities and
9 Exchange Commission on complicated securities issues under
10 our federal securities laws. The Court may even be familiar
11 with the North Carolina Attorney General's Office, claims
12 that were made—that has come up, I believe, in proceedings
13 here before. In that action that was not under a securities
14 statute; that was under North Carolina's pyramid statute. In
15 different states there's lottery statutes, there's pyramid
16 statutes, there's securities statutes.

17 The Federal Drug Administration will regulate a lot
18 of multi-level marketing companies that are selling
19 nutritional products; the Federal Trade Commission regulates
20 unfair and deceptive trade practices federally; and then in
21 most states you have unfair and deceptive trade practice
22 statutes that are similar but not always identical.

23 The pyramid statutes are not the same in different
24 states. They vary greatly as far as what needs to be done in
25 order for a company to be compliant with those laws, and many

1 multi-level marketing companies can make matters more legally
2 complex for them to operate nationwide. They are not just
3 operating in a single environment.

4 My point here, Your Honor, is that multi-level
5 marketing companies necessarily, because of the complexities
6 of what they're doing, if they wish to comply with the law,
7 need legal assistance. International Heritage from the very
8 beginning sought and obtained legal assistance. Locally,
9 Your Honor, they sought legal assistance from Georgina
10 Mollick with Ragsdale Liggett & Foley at that time; Dan Bell
11 with Wyrick Robbin Yates & Ponton (phonetic), and then they
12 also retained the services of a lawyer who is an expert in
13 multi-level marketing, a gentlemen by the name of Jeff Badner
14 out of Oregon.

15 Later in the history of International Heritage,
16 after the Attorney General's Office made claims or
17 allegations against the company in or around March or April
18 of 1997, additional attorneys became involved with the
19 company. At that time, I became more involved, my firm, Wood
20 & Francis, with the company in trying to assist them in the
21 regulatory environment with which they were involved. In
22 addition, they retained the services of Smith Anderson Blunt
23 Dorsett Mitchell here locally to also assist them.

24 Now, at that time, Your Honor, the Attorney
25 General's claims were not only made against the company but

1 they were made against Mr. Van Etten; they were made against
2 Mr. Savage and Mr. Smith. Myself, along with Smith Anderson
3 Blunt Dorsett & Mitchell, as well as the other lawyers, were
4 at that time providing legal advance, not only to the company
5 but also to other individuals, including Mr. Van Etten, Mr.
6 Smith, and Mr. Savage. Everyone consented to that, in part
7 because of the indemnification provisions in the bylaws and
8 the indemnification provision in the employment agreement.

9 After the Attorney General's Office initiated its
10 allegations against the company and that matter became
11 resolved, or about the time it became resolved, the
12 Securities and Exchange Commission, as the Court may be
13 aware, initiated an investigation. That investigation
14 started around the middle of 1997, and they were not just, as
15 the facts beared out to be, investigating International
16 Heritage; they were in fact investigating activities of
17 individuals, including Mr. Van Etten, Mr. Savage, and Mr.
18 Smith, and then by March of 1998, the SEC initiated their
19 litigation.

20 Now, when the SEC litigation was initiated, the
21 company and the individuals determined that it was necessary
22 to retain additional counsel, experts in securities law, and
23 they did retain the firm of Hutech Rock (phonetic) out of
24 Atlanta, Georgia. Ultimately, when the SEC initiated its
25 litigation, Hutech Rock and myself entered appearances in

1 Atlanta on behalf of not only both of the corporate entities—
2 if the Court will recall, it was at this same time, March of
3 1998, that International Heritage merged with Kara, Inc., and
4 became International Heritage, Incorporated—but there were
5 appearances made in those proceedings in Atlanta by myself
6 and by Hutech Rock on behalf of the individuals and the
7 corporate entities. Thus, they were being represented—were
8 not only representing the corporation; they were representing
9 individuals.

10 Thereafter, again as the Court is well aware, a
11 number of civil actions were initiated. There were civil
12 actions: two in Texas, two in Alabama, two in North
13 Carolina, and an administrative proceeding in Montana.
14 Additional lawyers had to be retained, if for no other
15 purpose but to try to coordinate these actions. They were of
16 great magnitude, purported to be class actions, and the
17 company and the individuals retained the services of joint
18 counsel, counsel out of Washington D. C., Deckard Price and
19 Rhodes; out of Alabama, Serodi and Permett; out of Texas,
20 Guardier and Wynne (phonetic spellings).

21 My point being, Your Honor, is that this is—and I'll
22 get to this more—this is very different than *Weintraub*, where
23 you have a true intermingling, because of the complexities of
24 what a multi-level marketing company does. You have lawyers
25 representing not only the company, the corporate debtor

1 entity, but also the individuals, and it was reasonable to do
2 it at that time, Your Honor. The companies are trying to
3 operate in a way that would maximize money for their
4 shareholders, which is their duty.

5 I would agree with Mr. Harden that the *Weintraub*
6 case is a case that we must look at, and we have addressed
7 that case, Your Honor, in our brief, and I will address it
8 again. We would contend that *Weintraub* is distinguishable.
9 *Weintraub* deals with an administrative issue. It's not a
10 criminal issue. We're not dealing with a criminal
11 investigation in *Weintraub* like we're dealing with here.
12 This is much more complex. In *Weintraub*, the attorney, Mr.
13 *Weintraub*, was asked to answer 23 questions, if I recall
14 correctly, in a deposition, and that is what became the
15 subject of the case itself that went to the Supreme Court.

16 As Mr. Harden correctly pointed out, it does not
17 deal with the work product privilege. It deals solely with
18 the attorney/client privilege. And I would point the Court's
19 attention very much so to what I believe is a final footnote
20 in *Weintraub*, which we address in our brief, and in that
21 footnote the Court points out the fact that they are not
22 dealing with the fiduciary duty that the trustee may have to
23 shareholders and to others.

24 Now, in this situation, Your Honor, the company
25 entered into an agreement with the bylaws and with the

1 employment agreement and said, "We will work together. We
2 will indemnify you in this situation. For everything that
3 you do when you're acting in your corporate capacities, we
4 will protect you." And now Mr. Harden is willing to just
5 drop that under the rug and forget about it, and we would
6 claim—we would argue, Your Honor, that that's not
7 appropriate. That is breaching a contract, a fiduciary duty,
8 we would argue, to these individuals and thus should not be
9 under these circumstances waived or forgotten.

10 We would also argue, Your Honor—and Mr. Smith is
11 going to address this much more than I will—that it's not in
12 the best interest of the debtor's estate for this Court to
13 approve this agreement. Mr. Harden has come to you today. I
14 understand his position about whether or not he needed to
15 come or not, but he has come here, and he's said, "I want you
16 to approve this settlement agreement," and he's presented
17 this settlement agreement. And I would encourage, I would
18 beg the Court, to look at that agreement because as Mr. Smith
19 will point out to you and as we've argued in our brief, Your
20 Honor, that agreement, with all due respect, doesn't hold
21 water. The U.S. Attorney's office is not offering anything
22 of substance to the debtor's estates. If Mr. Harden wants to
23 come in here and tell you, "I want you to approve this
24 settlement agreement," I would argue that the Court needs to
25 look at what that agreement is. There's not a written

1 agreement attached. It's a representation by the trustee,
2 and certainly Mr. Harden is of good character and he wouldn't
3 present anything that's incorrect, but there's not anything
4 in writing. The settlement agreements, while I have limited
5 agreement in here, all of the ones that I've seen, even the
6 Montana one that the trustee has just presented to the Court
7 for approval by motion, there is a written agreement. There
8 is a clear agreement about what the Court will be approving.
9 That is not the case here.

10 I will point out again that the work product
11 privilege is not addressed in *Weintraub*, and that makes it
12 very distinguishable, and as a result, the Court will have to
13 look at the work product privilege outside of the *Weintraub*
14 decision, we would contend.

15 Furthermore, Your Honor, and because of the
16 complexities of this, as I've already stated factually, the
17 waiver of the privilege would compromise the individual
18 privileges that a number of people, not just Mr. Smith and
19 Mr. Savage and Mr. Van Etten, whose names I've mentioned
20 specifically have, but other officers and directors who had
21 legitimate reason to ask about liabilities that they may have
22 in the situations with which this company was faced. And
23 that is, we would contend, extremely distinguishable. It
24 drags in additional--it's distinguishable from *Weintraub*--and
25 it drags in complex constitutional issues, the ability to

1 protect the right for someone to speak frankly with their
2 lawyer.

3 Under the cases, Your Honor—and actually I will
4 point out to Your Honor—we have looked at the *Weintraub* case
5 and all of its progeny that we can locate, and we cannot find
6 a case that really fits into this situation where you're
7 dealing with a complex criminal investigation. So again,
8 that would be another distinguishing factor.

9 As Mr. Harden pointed out, there is a possibility
10 that the U.S. Attorney's office may be presenting these same
11 issues to the District Court. We would contend that that is
12 where this is best presented. If the U.S. Attorney is going
13 to continue to investigate and potentially prosecute or
14 attempt to prosecute individuals and/or the corporations,
15 then these issues, very important constitutional issues,
16 should be before the District Court rather than trying to
17 force this Court to conduct potentially an *in camera* review
18 of the multitude of documents that are involved.

19 I will now address the issue about the number of
20 documents involved. Mr. Van Etten, directly or indirectly
21 pursuant to subpoenas delivered to him or to others, has
22 produced approximately 175,000 pages of documents that were
23 in, with all due frankness, essentially in my possession.
24 They're in my possession largely because I was the attorney
25 working on these matters, and the other documents that he had

1 relating to International Heritage were turned over to the
2 U.S. trustee after the petitions were filed. Those 175,000
3 pages, or whatever the number is, we would contend are not
4 privileged documents. There are another 30,000 that are
5 either attorney/client privilege or work product privilege.

6 Mr. Harden may not recall, but I have told Mr.
7 Harden since the beginning of this case that I had documents
8 in my possession that might in part arguably belong to
9 International Heritage and I would be glad to do whatever he
10 wanted, and I always understood that he wanted me to keep
11 those. I believe Ms. Gardner would back me up on those
12 representations to Mr. Harden, and it may be that she is the
13 one who told him that rather than me, but I feel extremely
14 confident saying it was presented--was told--to Mr. Harden.

15 It is from the privileged documents that we produced
16 pursuant to the subpoenas a list describing--and it is a long
17 list that describes these documents--in accordance with the
18 request of the U.S. Attorney's Office. Again, the purpose of
19 not producing these documents is not because anybody believes
20 they're liable or they're going to lead to some smoking gun,
21 but the privilege is important to everyone, and that's why
22 we're here today, that Mr. Harden correctly realized that
23 it's important to a lot of different people, and he put it
24 before the Court.

25 So, Your Honor, for the reasons that I've stated and

1 for the reasons that the other fine lawyers who are here
2 today will tell you, we believe it's inappropriate for the
3 Court to approve this request by the trustee. It's
4 distinguishable from *Weintraub*, it is a unique situation, and
5 the Court should deny the request, or, at the very least,
6 defer some ruling until something occurs over in Federal
7 District Court. We believe without a written agreement
8 submitted to the Court, that it would be inappropriate for
9 this Court to approve it, so there is a basis without ever
10 addressing the attorney/client privilege of the *Weintraub*
11 case to deny this motion.

12 So, based upon those points, Your Honor, I would
13 respectfully request that you deny the request of the
14 trustee. Thank you.

15 THE COURT: All right. Mr. Smith?

16 MR. SMITH: Thank you very much. Your Honor, we
17 appreciate very much the opportunity to be heard on this
18 very, very important matter, and I will not unduly trespass
19 upon the Court's time. I would like to make two points, and
20 Melissa Hill and I, as you now know, are appearing on behalf
21 of Mr. Van Etten, Mr. Steve Smith, Mr. Jack O'Hale, and Mr.
22 Joseph Cheshire, here representing other people, but there's
23 an agreement that I will make these remarks on behalf of all
24 of us, so I make these brief remarks, Your Honor, for
25 everyone.

1 Your Honor, we are, as you know, dealing with a
2 very, very important constitutional right, and a very
3 important piece of the liberty package, not to be dramatic
4 about it, but we believe that this is a very crucial piece of
5 the package of liberties that we have as Americans; and, of
6 course, as Your Honor knows, the Supreme Court has dealt with
7 this matter fairly frequently, and the most recent, as I
8 recall, is in 1998 in the case in which Vincent Foster, just
9 shortly before he died, spoke with his lawyer. His lawyer
10 took notes. The office of the special prosecutor, special
11 counsel, initiated a proceeding to get those notes on the
12 ground that the attorney/client privilege should not survive
13 death, the issue being that if the client dies, the privilege
14 ought to die. And Mr. Justice Rehnquist, speaking for a
15 majority in the United States Supreme Court, held that indeed
16 the attorney/client privilege is one of the most important
17 freedoms we cherish, and that it does in fact survive the
18 death of the client. So the attorney/client privilege was
19 once again reaffirmed in that important decision.

20 We have read *Weintraub*. We respect the decision in
21 *Weintraub*, and we respect the position of Mr. Harden. We
22 know he is excellent counsel and doing what he believes is
23 right, but we do not believe, Your Honor, that you should
24 permit this waiver. We think that this case does
25 significantly differ from *Weintraub*.

1 We don't know-I don't know-how many pages, documents
2 that Mr. Harden's talking about. I'm told that it could be
3 many thousands, maybe 30,000 pages. I don't know. I don't
4 know whether anyone has reviewed those pages carefully.
5 That's not before Your Honor. It's not on the record. We
6 know that in those 30,000 or so pages there may be letters
7 written by lawyers to individuals, not just to a corporation
8 but to individuals. Those letters may have been written
9 involving very important and crucial issues. They were
10 written by lawyers who believed when they wrote them that
11 they would never be public documents. They would include the
12 mental impressions of lawyers perhaps. We don't know. But
13 we would assume that there must be letters in there. There
14 may be copies of letters from individuals back to their
15 lawyers, but those individuals would never dream that those
16 would be public. We would have to assume that there may be
17 in that 30,000 or so documents drafts of pleadings, of
18 memoranda, mental impressions, opinions as to law, letters
19 containing legal advice. So we know that there may be within
20 those pages two kinds of privileges, attorney/client
21 privileges and work product privileges.

22 And if we had all those documents in front of us and
23 could look at them and we made a pie chart, we would say,
24 well, there must be a slice of that pie that would be
25 attorney work product; there would be a slice of that pie in

1 which there would be individual attorney/client privilege
2 documents; there would be documents that attorneys could
3 assert a privilege because those would be work product; and
4 there may be corporate attorney/client privilege documents.

5 So what we could say, Your Honor, without
6 embellishing this and without trying to use flowery language,
7 is that this is literally a hotbed of privilege issues, and
8 in that way differs significantly from *Weintraub*, a hotbed, a
9 veritable hotbed, a prickly bed of privilege issues involving
10 very important constitutional rights.

11 And Your Honor, we know that there's an excellent
12 United States Attorney assigned to this case, very, very
13 able. We know that he is working this case hard. There is a
14 federal grand jury convening. This United States Attorney is
15 absolutely capable of dealing with all these privilege issues
16 before sitting United States District Court Judges, who are
17 overseeing federal grand juries, who customarily every day
18 deal with criminal matters and who are there waiting to sort
19 out the prickly issues if they need to be sorted out.
20 And so, Your Honor, we respectfully ask, for those reasons,
21 that the Court not allow the waiver in this case.

22 So, our point number one is this. This case is
23 entirely different. This case involves very, very
24 significant and extraordinarily prickly issues that would
25 require separating documents out, looking at documents to see

1 which is which and what is what.

2 I'll make one additional point, Your Honor, and it's
3 brief, and then I'll sit down.

4 With all due respect to the United States Attorney,
5 who is, we submit, offering Mr. Harden everything that he
6 can, everything that he has the power to offer—he doesn't
7 have the power to offer any other things. The truth of the
8 matter is that what he's offering cannot under the law be
9 very much at all.

10 Looking at Mr. Harden's Motion for Proof of
11 Compromise and Settlement, he says first that the Assistant
12 United States Attorney will agree not to recommend or seek
13 the imposition of any criminal penalties. Well, Your Honor,
14 criminal penalties arise out of *Rico* actions, they are
15 mandatory with the United States District Court Judge, and we
16 would submit that, again with all due respect to the United
17 States Attorney, these decisions would be made by the
18 District Court Judge who would be sitting in this case,
19 standing before him being the convicted defendants, and what
20 he would do is by statute mandatory, and there's nothing, we
21 submit, that the United States Attorney can do for Mr. Harden
22 there.

23 The next thing the Motion for Approval of Compromise
24 and Settlement says is that the Assistant United States
25 Attorney will agree not to recommend or seek the imposition

1 of fines. Well, in this instance there is some discretion on
2 the part of the United States District Court Judge, but the
3 judge would make the decision about fines based on very
4 strict rules set forth by statute relating to the ability of
5 the convicted defendant to pay and so on. And we submit that
6 the U.S. District Court Judge would make decisions on those
7 fines based on the guidelines set forth in the statute.

8 Thirdly, the Assistant United States Attorney
9 promises not to recommend or seek imposition of any
10 forfeitures. But Your Honor, forfeitures again are strictly
11 limited by the statutes and are mandatory, and we submit
12 there's nothing the Assistant United States Attorney can do
13 to help Mr. Harden in the situation with forfeitures.

14 Now, further, the United States Attorney says that
15 he or she would use best efforts to ensure that any
16 restitution imposed in any criminal proceedings against any
17 individuals or entities or affiliated or otherwise associated
18 with one or both debtors would be distributed to the
19 creditors.

20 If Your Honor pleases, we submit that in looking at
21 restitution, United States District Court Judges provide
22 restitution to victims, and in this case the creditors, if
23 there were a conviction, would be the victims. And that
24 means that the judge would be providing restitution for the
25 creditors anyway.

1 So what we say is that Mr. Harden is not getting
2 anything for trading these valuable constitutional rights.
3 It is true that he's getting what the prosecutor has to
4 offer, but the prosecutor doesn't have anything to offer of
5 great significance. It is not a robust offer. It is a
6 little dainty tea cake of an offer. And a little dainty tea
7 cake of an offer should not be enough to cause the trustee to
8 waive the substantial rights of the people involved in this
9 case.

10 Thank you very much, Your Honor.

11 THE COURT: Okay. Anyone else? Mr. Cheshire, Mr.
12 Smith? Okay. Mr. Harden?

13 MR. HARDEN: I was not aware that the corporate
14 bylaws had an indemnification provision. I do know that Mr.
15 Van Etten's contract as executor has obviously been rejected
16 by the trustee simply because it wasn't assumed within the 60
17 days required, and I would also remind the Court that Mr. Van
18 Etten waived his claims against the estate when we settled
19 the SEC litigation in that global settlement.

20 Let me make it clear. I'm not proposing to waive
21 anybody's personal attorney/client privileges, and I'm not
22 proposing to waive Mr. Wood's attorney work product
23 privilege, because I don't think I can. But as Mr. Smith
24 pointed out, there are capable District Court Judges who
25 could take all these documents *in camera* and look at them and

1 tell the U.S. Attorney what will be admissible and what
2 won't, and I don't think we're talking about a hotbed of
3 prickly issues in that regard. I mean they're going to get
4 plenty of scrutiny by the District Court. It won't be your
5 job. All I want you to do is make it possible for me to
6 waive the privilege and have that inspection take place in
7 that court.

8 I mean I don't have a written, specific, detailed
9 written letter from Mr. Wilkinson. I do have a letter from
10 Mr. Wilkinson, which I understood was the extent to which he
11 could memorialize our agreement. I probably should have
12 brought that today, but I didn't. It's similar to what is
13 contained in the motions. It's very simple. It does not
14 embellish much, if at all, what I've noticed out to
15 creditors, but I'm sure that if the Court enters an order
16 approving this settlement, if you find other parameters
17 necessary, you can put those in the order, and that that
18 would suffice very satisfactorily.

19 I did know that there were documents in Mr. Wood's
20 possession, but I understood that Mr. Wood was reserving
21 those documents and had no intention whatsoever of turning
22 those over to me, and if for no other reason, Your Honor, you
23 know, we need to waive the privilege so I can see the
24 documents. I want to see those documents. I don't know how
25 I'm going to get them if Mr. Wood is telling me that

1 everything is privileged and that's why he took it to his
2 office. You know, I need some authority to get into those
3 documents, and this is as good a time and place as any. I
4 believe it's my duty to the creditors to inspect all of that
5 and see if there's anything there that needs to be brought
6 up.

7 The deal is obviously the best that the U.S.
8 Attorney can offer. I believe, Your Honor, that the--and Mr.
9 Smith is exactly right. This has occurred to me a thousand
10 times. If there were crimes, then the creditors in this case
11 were the victims, and I think that it is their right to
12 collect any restitution that might be payable. It's my
13 understanding that the restitution is not--that fines, you
14 know, fines, for example, would have to be paid, or that
15 there may be rigid statutory requirements about how money is
16 spent, but I understood from Mr. Wilkinson that there was
17 discretion of the court, in the District Court, and that he
18 would do his best to help us formulate a way, since we have
19 this bankruptcy in place, formulate a way to get the money
20 funneled in to the creditors, who would, if there are crimes,
21 be the victims.

22 I don't want to participate in a criminal trial. I
23 want to minimize the estate's involvement in this case. And
24 that aspect of it shouldn't go unacknowledged. I don't want
25 to get involved in a crime fraud exception argument over in

1 the District Court. If we take this whole thing over there
2 and he tries to--and Mr. Wilkinson says to the District Court,
3 "Well, you know, all this attorney advice was given in the
4 context of a pyramid scheme and it's all a fraud and
5 therefore none of this stuff is privileged anyway," I'm going
6 to be drawn into that fight. But if I get drawn into that
7 fight, there's no benefit for the creditors because there's
8 no deal.

9 So, you know, I strongly believe that the best thing
10 we can do is waive the privilege and let the District Court
11 sift through the documents, decide what's privileged and what
12 isn't, and that way we'll at least permit some benefit to the
13 creditors if that's possible down the road.

14 THE COURT: Mr. Wood?

15 MR. WOOD: Thank you, Your Honor. Just a few
16 points. First, Your Honor, any rejection of the employment
17 agreement, we would contend, by Mr. Harden as under
18 bankruptcy law, would not, we would argue, limit Mr. Van
19 Etten's rights to enforce that at this time.

20 Secondly, the settlement with Mr. Harden speaks for
21 itself, and we would argue that that is not a waiver as to
22 this claim at this time. That it may be a claim that may be
23 asserted in the future by Mr. Van Etten under an
24 indemnification provision.

25 And on that same point, Your Honor, Mr. Etten's not

1 the only party involved here. I represent Mr. Smith in this
2 proceeding, and there are other parties who would have those
3 same rights of indemnification. I'm not aware of all the
4 employment agreements, but certainly the bylaws speak for
5 themselves.

6 As to the documents that I have, to my knowledge Mr.
7 Harden's never asked for them before today. This is the
8 closest he's ever come to asking for them. Obviously there
9 was some misunderstanding between us, and Mr. Harden looking
10 at the documents is a far cry from waiving the privilege.
11 They're two different worlds apart. Mr. Smith eloquently
12 explained that to the Court.

13 And we would contend finally, Your Honor, that Mr.
14 Harden is not necessarily minimizing the involvement of the
15 estate in these proceedings by waiving this privilege. I
16 believe that the agreement could be interpreted that the
17 company can still be prosecuted, and that could involve a
18 large amount of work, or if, as it has in the Montana case
19 and even in the SEC case, Mr. Harden's involvement was
20 limited in the actual proceedings themselves.

21 So, as a result, we would again argue or urge this
22 Court to deny the request of the trustee, and if the Court is
23 inclined at all, we would urge this Court, very much so, to
24 place strict limitations as far as what the Court's ruling on
25 related to work product privilege and individual privileges

1 of a lot of different people, including my individual clients
2 in this proceeding, Mr. Van Etten and Mr. Smith.

3 Thank you, Your Honor.

4 THE COURT: Mr. Smith?

5 MR. SMITH: Nothing further. Thank you, Your Honor.

6 THE COURT: Okay. Well, the Court certainly
7 recognizes the importance of the attorney/client privilege,
8 but we also have some very strong authority in the *Weintraub*
9 case that a Chapter 7 trustee for a corporation can waive the
10 privilege. Before I rule on this matter though, I have not
11 had a chance to read the brief that you've handed up today,
12 and I want to read that. I'll try not to take very long with
13 it, and I'll let you know my decision. If I do decide to
14 allow Mr. Harden's request, I will make it clear exactly what
15 it is he can and cannot get.

16 Anyway, thank you. That will conclude our hearing,
17 and I'll take this matter under advisement.

18 (HEARING CONCLUDED)

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In Re: International Heritage, Inc.
International Heritage, Incorporated
99-02675-5-ATS
99-02674-5-ATS

C E R T I F I C A T E

I, Jane W. Clapp, having been tested and approved by the Administrative Office of the Court in Washington, D.C., to provide transcription of legal proceedings from electronic sound recordings, do hereby certify that the foregoing is a true and accurate transcript, to the best of my ability, of the above entitled matter.

Jane W Clapp 7-26-00
Jane W. Clapp Date